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PORTFOLIO MANAGER'S COMMENT FEBRUARY 2012

MARKET OVERVIEW:

- The strong start of 2012 for global equities, especially emerging ones, continued in February. Liquid emerging European markets were among global top performers as attractive valuations in most sectors and increased risk-taking by global investors, attracted fresh funds to the region.
- Nevertheless, Bulgarian indices declined in February (SOFIX -2.9%, BG40 -3.9%), as the improved global sentiment, following the approval of the second bailout package for Greece and strong macro data, coming from major economies was not reflected by the local market. REIT companies continued to be among top gainers on BSE Sofia but their price growth decelerated to 4% as measured by BG REIT index, compared to 10% gain in January. We note that since March 1 BSE has effectively created a new segment BaSE where all illiquid companies would be traded. Although this decision might not have a significant influence on the market as a whole, we note that it might put some small but prospective companies off investor's radar.
- Q4 reporting season of BSE-listed companies continued during the period but failed to trigger index movements as the QoQ sales growth slow down and profitability deterioration were already expected.
- During the period NSI released its flash estimate for Bulgarian GDP in 2011. 2011 real GDP growth of 1.7% YoY came well below government forecast of 2.8%. Main reasons behind the 0.4% QoQ drop in Q4 were weak gross fixed capital formation which decelerated to -6.5% YoY, supposedly on deteriorating outlook for European Economy and inventories destocking, and weakening local consumption (+1.4% YoY in Q4, +1.7% YoY in Q3) on high unemployment.
- Russian indices were again among Top 5 performers in Europe, rising by 7% (RTS in USD), following a late surge in February on strong oil price as Brent crude, reached highest price since August 2008. Blue-chip companies outperformed in end-month and managed to catch up with the strong start of the month from small and mid caps, despite political headwinds.
- As expected policy was the main factor to watch in February as Putin made several unconventional moves and promises in order to attract blue-collar votes. Among negatively-affected companies from his re-election campaign were: the second-largest bank VTB [VTBR LI], which was requested to perform a buyback at 2007 IPO price for eligible retail shareholders, the management of most utility companies, blamed for corruption, and Rosneft [ROSN LI] which was proposed for strategic investor in Novorossiysk Commercial Sea Port [NCSP LI]. Additionally, Putin proposed a one-time levy on all the beneficiaries of allegedly unfair privatisation of the mid-1990s. However, despite the short-term declines in selected shares, they recouped losses on easing political risk as Putin significantly strengthened his positions and chances for a first round win.
- Macro data was also supportive for the Russian investment case. Retail trade growth remained strong although at 6.8% YoY in January was below expectations. Investments surprised the market positively, increasing by 15.6% YoY, including a 21.5% YoY growth in housing construction in January. Part of this surge may be attributed to the increased budget expenditures since start of the year as the federal budget started the year in deficit. However, we note that PMI Manufacturing decelerated slightly to 50.7 in February as demand from abroad continues to ease which might threaten growth in post-election period.

PORTFOLIO ALLOCATIONS:

FFBH Vostok

- In February FFBH Vostok with 8% MoM and 20.6% YtD return was the best performing Bulgarian mutual funds. During the period we chose to remain almost fully invested in equities as we deemed that rising global risk appetite and higher support for Putin's nomination were all in favour of Russian equities.

FIB Avangard

- In FIB Avangard we kept on following our strategy to decrease the weight of Bulgarian shares, selling some REITs and food & tobacco companies that reached our target levels. Our foreign portfolio remained unchanged during the period and managed to compensate for the lacklustre local market, thus, bringing the monthly return to 1.8%.

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FIB Classic

- In February we followed our short-term strategy and increased the dividend yield of our equity portfolio by adding domestic preferred stocks. We decided to cash in the profits from our foreign bond positions as we expected that the rally in bank bonds since start of 2012 would reach a saturation point. We also decreased our domestic bond allocations on rising credit risks for individual positions.

FIB Garant

- In FIB Garant we also managed to improve the dividend yield of the equity portfolio. Similarly to FIB Classic we disposed of some foreign bank bonds on hitting internal target levels and local corporate bonds on rising credit risk.

OUTLOOK & STRATEGY:

- In February business confidence and sentiment indicators in EU continued to improve although lagging data, including EU-27 real GDP data for Q4 (-0.3% QoQ), continued to point to a mild recession. The improved sentiment, combined with the strength of the US economy and easing of Chinese monetary policy acted in favour of commodities and global emerging markets with Eastern Europe being a regional outperformer again. Now, that US indices are close to 2008 highs, while Europe is expected to at least stagnate on fiscal tightening, we deem that investors would selectively take advantage of some undervalued emerging markets in the short-term. Still, we remind that most of the risk factors that were behind the market collapse last year are still in place and investors should not get carried away and follow economic news closely.
- In Bulgaria business sentiment and consumer confidence weakened last month, pointing to a slow start for the economy. As mentioned above stock performance lagged behind more liquid Eastern European markets again which would probably be the case by mid-2012. Still, we note that Bulgaria is among the most attractive capital markets in Eastern Europe based on both trailing and forward P/Es and, if global backdrop remains supportive, this might lead to increased interest and outperformance in H2 2012.
- The most significant short-term domestic events are related to government's privatization plans, including the remaining stakes in the electricity distribution sector. In March the 2011 audited non-consolidated financial reports are to be published which always brings some surprises and restatements but we believe that they may trigger meaningful market movements only for companies with set-up dividend policy such as REITs.
- Despite the strong start of 2012, Russian equities continued to trade at larger than usual discount to other emerging markets. We deem that this valuation gap would start to close after the March 4 election, in case of peaceful post-election period and supportive global environment. Also, we expect that state policy would shift from anti-inflationary to pro economic reforms which would unlock some value, especially, in suppressed utility sector.
- Overall, our long-term focus on Russian equities remains in place on resilience of local economy and strong debt profile, supported by high oil price and strong domestic demand potential on growing middle class. The high market beta is also positive for the Russian investment case, if monetary policy in major economies remains expansionary and Eurozone debt crisis continues to unravel.
- In Bulgaria we shall continue to stick to blue-chip companies, while further decreasing investments in less liquid and highly-leveraged companies across all funds.
- In conclusion we expect that equity allocation will remain high in FIB Avangard and FFBH Vostok and will be increased slightly in FIB Classic and FIB Garant in March but we are ready to collect some gains in some defensive plays and increase the weight in foreign cyclical stocks and sectors that underperformed during Autumn 2011.